



February 22, 2011

Via Electronic Mail Delivery

Jennifer J. Johnson
Secretary
Board of Governors of
the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

*Re: Notice of Proposed Rulemaking (Docket No. R-1404, RIN No. 7100 AD63)
Regarding Debit Card Interchange Fees and Routing*

Dear Secretary Johnson:

Thank you very much for the opportunity to comment on the Board of Governors of the Federal Reserve System's (the "Board") proposed rulemaking regarding Debit Card Interchange Fees and Routing (the "Proposal"). TD Bank, N.A. (the "Bank") is an indirect, wholly-owned subsidiary of The Toronto-Dominion Bank and is one of the 10 largest banks in the United States based on deposits. The Bank prides itself as being "America's most convenient bank" and we are passionate about our relationship with our customers and the products and services we provide to them. The bank has consistently been recognized as a leader in customer service.

The Bank understands and supports the proposition of transparency in pricing of all banking fees, including debit interchange fees, as well as being open and transparent in communicating with our customers. We have serious concerns with the Board's interpretation and proposed approach in implementing the Durbin amendment and believe, if implemented as proposed, the Proposal will bring more confusion and less transparency to the marketplace than exists today. For the reasons more fully set forth below, the Bank believes that the Board's approach in determining the incremental costs associated with an issuing bank's debit interchange transactions is both theoretically and factually flawed. The limited approach the Board has taken in making this determination, and then setting a cap on interchange fees that is effectively equivalent to that flawed interpretation of cost, will have a number of unintended consequences both to the banking industry but more importantly to the customers it serves. Product features and

services that have been the hallmark of the debit business, such as convenience, guaranteed payment and wide availability, may become limited or cease to exist altogether. The value of an efficient payment system will be degraded as those who have built and maintain that system are unable to recoup their costs and will be reluctant to make further capital commitments thereby stifling further improvements or innovation.

Rushing to implement rules without taking the time to do the requisite diligence required could adversely affect a well functioning payment system and set back by years the evolution of electronic point of sale payments from cash and paper checks. This does not have to be the result. The Board, working with all affected constituencies in the debit interchange process, can still achieve a more equitable outcome for all involved.

General Comments

As a general proposition the Bank believes that all banking fees, including debit interchange fees, should be reasonable, transparent and known to, as well as understood by, the consuming public. However, a regulatory mandate that takes into account only those variable costs incurred by the issuing bank in the authorization, settlement and clearing of a debit interchange transaction is inconsistent with this notion of transparency and results in setting a price for those transactions that is far below what it actually costs banks to provide debit card services to their customers. The Board concedes in its Proposal that only a subset of the total cost of providing debit card services to consumers was considered and even anticipated that issuers will assess other fees to consumers to offset the impact of these changes. The proposed fee cap of between 7-12 cents is roughly 80 percent below the current industry standard. As a result, virtually every bank or credit union subject to the Proposal will be required to reassess not only whether they can continue to engage in this business profitably as a more convenient alternative to checks and cash, but also what affects the newly aligned business model will have on its customers.

Debit Interchange Cap

The Durbin amendment authorizes the Board to implement rules that establish “standards for assessing” what constitutes reasonable and proportional debit interchange fees when compared to costs incurred by issuing banks in making the product available. The Federal government has itself recognized this point.¹ The Proposal, however, has turned this authorization on its head. Rather than acknowledging the costs that issuing banks incur in the process and then determining whether the fees associated with such costs are reasonable and proportional thereto, the Proposal has the effect of determining whether the costs themselves are reasonable and proportional and then assumes that the

¹ “Section 1693o-2(a)(3)(A) [of the Electronic Fund Transfer Act, as amended] states that the Board shall prescribe regulations “to establish standards for assessing whether the amount of any interchange transaction fee” is ultimately “reasonable and proportional to the cost incurred by the issuer with respect to the transaction.” These “standards” could include a defined rate or could provide a general framework under which the networks prescribe the amount of any interchange transaction fee. Either way, the statute does not mandate a fixed rate.” Defendants Brief, *TCF National Bank v. Ben S. Bernanke, et. al.*, p.31

fees cannot exceed these costs. This amounts, plain and simply, to price fixing. And it's price fixing for only one part of the value chain; that which is being provided by the largest issuing banks. In short, the Proposal disregards the statutory mandate, creates an inequitable pricing mechanism and places the burden of this failed approach squarely on the backs of banks.

Under the Proposal, the networks will be free to continue to negotiate fee arrangements with acquirers and acquirers may carry on as usual with merchants. The Proposal assumes that merchants will pass on the "savings" resulting from lower interchange fees to their customers. While economic theory may dictate that this should be the result, it is not required under the terms of the Proposal and, we submit, will not likely be the case in reality. We believe that the net result of the imposition of a fee cap at the level set forth in the proposal will be to shift the cost of point of sale debit payments completely to issuing banks from the large merchant community. Merchants derive significant cost savings and benefits from the debit interchange system and it is not unreasonable for issuers to provide this service at a profit that enables further investment to improve the system and encourages more consumers to use the system. The Board's current proposal will break this ecosystem. Accordingly, we request that the Board revisit its determination as to what are truly reasonable and proportional fees associated with debit interchange transactions and recognize the true costs related to those transactions. As to the two fee alternatives proposed by the Board, the Bank would be more inclined to support Alternative Two that sets one capped fee and does not require the added cost and complexity of issuer-level documentation and regulatory certification. We do reiterate, however, that we do not agree that 12 cents is the appropriate cap. We would also favor an interchange fee option based on a volume and risk-weighted average imposed at the network level.

Allowable Costs

The Proposal further erroneously assumes that fees cannot exceed "incremental costs" and that incremental costs are meant to be only those *variable* costs associated with the authorization, clearing and settlement of a debit interchange transaction. This reasoning conveniently disallows the inclusion of any fixed costs associated with the development, maintenance or improvement of the debit payment system and also removes, or doesn't include, consideration of other very important variable costs such as those associated with fraud prevention programs and the continuing maintenance and upgrading of the systems supporting such programs. This will ultimately redound to the detriment of the consumer. Not allowing issuers to recoup certain variable and fixed costs for maintaining and improving the debit system (such as processing, card issuance, customer service, fraud prevention, back office compliance and marketing and related systems hardware and software costs) will stifle further capital expenditure and limit product innovation. Ultimately, a system that has become known as a safe, secure and convenient alternative to cash or check payments will become stagnant or even decline in convenience and safety. There is also the real possibility that the debit product may become less widely available or more costly to consumers as issuing banks determine not to take undue credit risk in what will become an increasingly unprofitable line of business.

Many of these fixed costs are associated with services that are inextricably integrated into the totality of that which constitutes the debit interchange system and which the customer receives free of charge. Products and services like free statements, ATM access, on-line bill payment capability and fraud protection are supported through revenue derived from debit interchange fees. As noted above, the net effect of disallowing fixed and certain variable costs from inclusion in the calculations under the Proposal will cause banks to charge for these services, potentially discontinue offering them and/or limit the availability of them to certain segments of consumers. We submit that limiting the universal availability of inexpensive or free banking services was not the goal Congress was trying to meet through enactment of the Durbin amendment but will be, unfortunately, one of the unintended consequences of the Proposal.

ATM Transactions

We also believe that ATM networks or transactions should not be included within the scope of the final regulations relating to debit interchange transactions as they are not within the scope of Congress' mandate under the Durbin amendment. In general, banks provide ATM cards and access to various ATM networks as a convenience to their checking and savings account customers. The underlying financial dynamics of the ATM business differ greatly from debit interchange transactions and the two lines of business should not be treated in the same manner. In the case of ATM transactions the issuer pays the acquirer, unlike debit transactions where the acquirer pays the issuer.

Approach to Fraud Prevention

Allowance should be made for fraud prevention costs and fraud losses with adequate flexibility to drive the appropriate point of sale behavior. The preferred approach to the fraud prevention framework would be to focus on reasonable steps for an issuer to maintain an effective fraud prevention program but would not prescribe specific new technologies that must be employed. The Board could adopt non-prescriptive standards that an issuer must meet. In doing so, we strongly recommend the Board provide additional interchange fee allowances to offset the cost of fraud prevention, recommend the non-prescriptive approach and believe that the technology-specific approach would be detrimental to all parties involved.

General Purpose Re-loadable Cards

While we agree that general purpose re-loadable cards should be exempt from the interchange cap, specifying that the cards must debit a central account rather than an individual account is problematic. The Board recognized "there is little difference" between the two approaches, but claimed that "prepaid accounts that access separate accounts are not significantly different from debit cards that access demand deposit accounts." This determination fails to recognize some very significant differences.

With a prepaid or re-loadable card, the consumer has established funds in advance of any transaction that would debit those same funds. With a debit card and demand deposit account, the consumer may be subject to overdraft fees and/or other service charges that are associated with the underlying account.

Many banks view general purpose re-loadable cards as a potential means to better serve the needs of low balance customers and/or the “unbanked”. However, if interchange on these accounts were capped at the same level as debit cards, this option would most likely no longer offer a profitable alternative to serve those consumers. How the accounts are managed on the ledgers of the issuer should be immaterial to the Board and the Board should not mandate the creation of additional infrastructure changes that serve no purpose to any of the parties involved.

ATM-Only Cards

The board should also strongly consider excluding ATM-Only cards from the rulings on network non-exclusivity. These cards are typically provided to customers upon special request when certain customers want a limited-access card for security reasons. If these cards were to fall under the same requirement for multiple networks, that would effectively eliminate the key feature that customers have requested in those cards. Such ATM-only cards should be exempt from any requirement to include a signature debit network. Failure to exclude this requirement for such products will create significant dissatisfaction with many security-focused consumers.

Conclusion

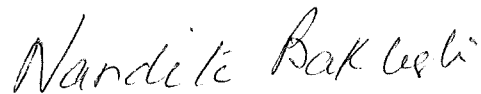
The Bank believes in transparency in pricing. We are supportive of the model offered in Alternative Two of the Proposal relating to establishing a debit interchange fee but disagree that the 12 cent cap is at all appropriate. We would also favor an interchange fee option based on a volume and risk-weighted average imposed at the network level. We recommend an incremental allowance for fraud prevention and recommend the non-prescriptive approach. Additionally, we recommend simplifying the stipulations surrounding general purpose re-loadable cards to prevent adverse impacts on low balance customers or the “unbanked.” Finally, the Bank believes that it would be inappropriate to include ATM transactions and ATM-only limited use cards within the scope of debit interchange regulations.

The bank disagrees with the approach set out in the Proposal in setting a debit interchange cap and believes it disregards the Durbin amendment’s mandate to establish standards for assessing whether an interchange fee is reasonable and proportional to the related costs incurred by an issuing bank with respect to those transactions. We are also concerned that given the enormity of the consequences to all of the constituencies involved in this process, including issuing banks, network providers, merchants and, most importantly, consumers, that adequate time be given for a more fulsome consideration of the effects of the Proposal on each of these groups. Congress never fully debated the Durbin amendment and no vote on the amendment was ever taken in the House of

Representatives. No analysis of the impact of the Durbin amendment on each of these groups was ever presented to Congress. The Bank believes that at least these and perhaps other actions should be taken before a regulation of such magnitude becomes final. We are also mindful that even if final regulations were issued in April as proposed, there would simply be insufficient time between that date and the July 21, 2011 effective date to make the systems, contractual, compliance and other changes necessary for effective implementation. The process simply needs to be slowed down and these issues be more closely examined. In order to do so, the Bank recommends that Congress extends the July 21, 2011 implementation of all components of the Durbin Amendment or that the effectiveness of the Proposal, if it is the final regulation in place on that date, be delayed until a more thorough and thoughtful analysis of all these issues can take place.

Thank you very much for the opportunity to let the opinions and observations of the Bank be heard on this vitally important topic. We look forward to working with the Board and its staff going forward. Please feel free to contact me at (856) 470-5993 with any thoughts or comments you may have.

Very truly yours,



Nandita Bakhshi
Executive Vice President
Group Head, Product Management

cc: Hon. Timothy P. Johnson
Chairman, US Senate Committee on Banking, Housing and Urban Affairs

Hon. Richard C. Shelby
Ranking Member, US Senate Committee on Banking, Housing and Urban Affairs

Hon. Spencer Bachus
Chairman, US House of Representatives Committee on Financial Services

Hon. Barney Frank
Ranking Member, US House of Representatives Committee on Financial Services